

## Message Text

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PAGE 01 CARACA 00325 01 OF 02 092217Z

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ACTION ARA-10

INFO OCT-01 AF-06 EA-07 EUR-12 NEA-10 ISO-00 FEA-01

ERDA-05 AID-05 CEA-01 CIAE-00 CIEP-01 COME-00 DODE-00

EB-07 FPC-01 H-02 INR-07 INT-05 L-03 NSAE-00 NSC-05

OMB-01 PM-04 USIA-06 SAM-01 OES-03 SP-02 SS-15 STR-04

TRSE-00 JUSE-00 PA-01 PRS-01 OPIC-03 FRB-03 XMB-02

/135 W

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P R 092120Z JAN 75

FM AMEMBASSY CARACAS

TO SECSTATE WASHDC PRIORITY 1511

INFO AMEMBASSY ALGIERS

AMCONSUL DHAHRAN

AMEMBASSY JAKARTA

AMEMBASSY JIDDA

AMEMBASSY KUWAIT

AMEMBASSY LAGOS

AMEMBASSY LIBREVILLE

AMEMBASSY LONDON

AMEMBASSY MEXICO

AMEMBASSY PORT OF SPAIN

AMEMBASSY QUITO

AMEMBASSY TEHRAN

AMEMBASSY TRIPOLI

AMEMBASSY VIENNA

USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 1 OF 2 CARACAS 0325

E.O. 11652: GDS

TAGS: ENRG, VE

SUBJECT: PETROLEUM - THE OUTLOOK AFTER NATIONALIZATION

1. BEGIN SUMMARY: THE GOV IS TAKING ITS TIME IN REACHING

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PAGE 02 CARACA 00325 01 OF 02 092217Z

FINAL AGREEMENTS WITH THE COMPANIES IN THE WAKE OF NATIONALIZATION.

ONLY EXXON HAS SO FAR SIGNED OFFTAKE AND TECHNICAL SERVICES CONTRACTS. WE EXPECT THE GOV TO HOLD THE LINE ON PRICES DURING THE FIRST QUARTER. BUT OFFTAKE WILL BE LOW, PROBABLY NO MORE THAN 1.5 MILLION B/D. THE GOV WILL PRESS FOR OPEC ACTION TO ENSURE FIRMER PRICE PATTERNS. IF THAT EFFORT IS UNSUCCESSFUL CARLOS ANDRES PEREZ WILL HAVE TO DECIDE WHETHER TO ACCEPT LOWER REVENUES AND PERHAPS A CUTBACK IN HIS AMBITIOUS DEVELOPMENT PROGRAM OR MOVE TOWARD A MORE FLEXIBLE POLICY. THE NATIONALIZED INDUSTRY SHOULD OPERATE WITH REASONABLE EFFICIENCY OVER THE SHORT RUN, BUT THE POSSIBILITY OF POLITICAL INTERFERENCE POSES A THREAT IN THE LONGER TERM. THE GOV PLANS TO SPEND SUBSTANTIAL SUMS IN DEVELOPING A PETROLEUM TECHNOLOGY CAPABILITY IN VENEZUELA BUT WILL BE DEPENDENT ON THE OUTSIDE IN THIS FIELD FOR A LONG TIME TO COME. THAT FACT IS PERTINENT TO THE DECISIONS THAT SHOULD BE TAKEN BEFORE TOO LONG WITH RESPECT TO THE ORINOCO PETROLIFEROUS BELT. END SUMMARY.

2. ALTHOUGH NATIONALIZATION HAS BEEN PROCLAIMED AND THE DEAL STRUCK WITH EXXON, THE PROCESS OF ESTABLISHING VENEZUELA'S NATIONALIZED PETROLEUM INDUSTRY ON A SOUND BASIS IS FAR FROM OVER. AS OF JANUARY 9 ONLY EXXON HAD SIGNED TECHNICAL ASSISTANCE AND OFFTAKE CONTRACTS. OTHER COMPANIES LACKING EXXON'S MARKETING VOLUME AND VERSATILITY MAY IN THE END REFUSE TO PAY VENEZUELA'S NON-COMPETITIVE PRICES FOR EVEN ONE QUARTER. IT IS CLEAR THAT THE GOV IN EACH CASE WILL INSIST ON A FIRM OFFTAKE COMMITMENT AS A PREREQUISITE TO SIGNING A TECHNICAL SERVICES CONTRACT. THE PROSPECT IS FOR WEEKS--PERHAPS MONTHS--OF MORE HARD BARGAINING BEFORE ALL NEGOTIATIONS ARE COMPLETED.

3. THE KEY ISSUE HAS BEEN AND REMAINS PRICE. THE COMPANIES TELL US THAT THE QUOTATIONS RUN FROM 10-45 CENTS ABOVE MARKET FOR A VARIETY OF CRUDES AND UP TO A DOLLAR TOO HIGH FOR PRODUCTS. THEY WERE DISMAYED TO FIND THAT THE PRICES OFFERED AT THE BEGINNING OF DECEMBER WERE NON-NEGOTIABLE. CARLOS ANDRES PEREZ SUMMED UP THE GOV'S PREVAILING PHILOSOPHY IN HIS NEW YEAR'S SPEECH: "IT IS MORE IMPORTANT THAT PRICES REMAIN FIRM THAN THAT WE SELL MORE BARRELS BY YIELDING TO PRESSURES FROM THE COMPANIES WITH A (RESULTING) DANGEROUS WEAKENING OF OPEC." THE GOV ADHERES SO FAITHFULLY TO OPEC PRICES AS A MEANS OF

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PAGE 03 CARACA 00325 01 OF 02 092217Z

SURVIVAL. IF OPEC UNITY ON PRICES WERE TO COLLAPSE, VENEZUELA'S MARKET SHARE IN NORTH AMERICA (ALREADY DECLINING SHARPLY) AND ELSEWHERE WOULD BE IMMEDIATELY VULNERABLE TO ITS LOWER-COST AND HIGHER-VOLUME COMPETITION.

4. COSTS ARE RISING AS PRODUCTION DROPS. PETROVEN PRESIDENT ALFONZO RAVA  
FORECASTS EXPORT SALES OF 1.5 MILLION B/D AND

TOTAL PRODUCTION OF 1.7 MILLION B/D DURING THE FIRST QUARTER, OR  
A 28 PERCENT REDUCTION FROM 1975'S FULL YEAR AVERAGE. IN  
ADDITION, THE RATIO OF CRUDE TO REFINED PRODUCT EXPORTS MAY  
CHANGE UNFAVORABLY. WE UNDERSTAND THAT LITTLE IF ANY PRODUCT  
HAS BEEN SOLD IN RECENT WEEKS FROM CHEVRON'S BAJO GRANDE REFINERY,  
THE ARCO AND GULF REFINERIES AT PUERTO LA CRUZ, OR EXXON'S  
QUIRIQUIRE REFINERY. ON THE BRIGHTER SIDE FOR THE GOV AS THE  
YEAR GOES ALONG IS EXXON'S COMMITMENT TO LIFT A DAILY AVERAGE  
OF 965 THOUSAND B/D IN 1976. IF THE COMPANY'S OFFTAKE IS LIMITED  
TO 800 THOUSAND B/D DURING THE FIRST QUARTER, SUBSEQUENT LIFTINGS  
WILL HAVE TO GO UP TO SOMETHING OVER ONE MILLION B/D.

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PAGE 01 CARACA 00325 02 OF 02 092230Z

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C O N F I D E N T I A L SECTION 2 OF 2 CARACAS 0325

5. IN THE MEANTIME PETROVEN PLANS AN INVESTMENT PROGRAM  
DESIGNED TO MAINTAIN PRODUCTION CAPACITY AT 2.2 MILLION B/D.  
(WE ESTIMATE THAT VENEZUELA COULD PRODUCE AT APPROXIMATELY THAT  
RATE FROM CONVENTIONAL RESERVES FOR ABOUT 20 YEARS IF THE PRICE  
HOLDS.) PETROVEN AND THE GOV WANT TO SELL THE EXTRA 500  
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PAGE 02 CARACA 00325 02 OF 02 092230Z

THOUSAND B/D (DESPITE CONSIDERABLE TALK ABOUT CONSERVATION)  
BUT SO FAR HAVE NO TAKERS. (IN FACT, WITH NEGOTIATIONS STILL  
PENDING IN SO MANY QUARTERS, IT IS UNCERTAIN THAT THE 1.5  
MILLION B/D TARGET WILL BE MET.) PRESIDENT PEREZ ANNOUNCED  
JANUARY 1 THAT MINISTERIAL TEAMS WOULD FAN OUT WORLD WIDE IN  
SEARCH OF NEW MARKETS. BUT MINES MINISTER HERNANDEZ AND ALFONZO  
RAVARD HAVE SUBSEQUENTLY THROWN COLD WATER ON THAT NOTION.  
HERNANDEZ ALSO REPUDIATED A PUBLIC SUGGESTION BY THE VENEZUELAN  
AMBASSADOR IN LIMA THAT SPECIAL ARRANGEMENTS MIGHT BE MADE ON  
A GENERAL BASIS FOR THIRD-WORLD COUNTRIES BUYING OIL FROM THIS  
COUNTRY. THE GOV IS FULLY AWARE THAT DEPENDENCE ON THE NORTH  
AMERICAN MARKET WILL CONTINUE FOR THE FORESEEABLE FUTURE.

6. WE EXPECT THAT THE GOV WILL HOLD FIRM ON PRICES DURING  
THE FIRST QUARTER WHILE HERNANDEZ AND HIS COLLEAGUES TRY TO FORGE  
STRONGER OPEC UNITY. THE CRUNCH WILL COME IN THE NEGOTIATIONS  
FOR SECOND-QUARTER PRICES. UNLESS OPEC ACTION OR OTHER FACTORS  
HAVE MATERIALLY STRENGTHENED THE MARKET, THE GOV WILL BE FACED  
WITH A CONTINUING LOW LEVEL OF OFFTAKE AND PERHAPS EVEN FURTHER  
REDUCTIONS. CARLOS ANDRES PEREZ WOULD THEN HAVE TO DECIDE WHETHER  
TO ACCEPT A DEGREE OF WHAT WOULD PASS HERE FOR AUSTERITY OR  
ADOPT A MORE "FLEXIBL" PRICING POLICY. THE PRESSURE TO MAINTAIN  
THE REVENUES NEEDED FOR THIS EXTRAVAGENT DEVELOPMENT PROGRAM  
WOULD BE SIGNIFICANT.

7. AS FOR THE INDUSTRY ITSELF, WE ANTICIPATE NORMAL OPERATIONS  
OVER THE SHORT RUN. PETROVEN HAS COMPETENT MANAGEMENT (ALTHOUGH  
WE HEAR RUMORS OF DISCORD BETWEEN THE BOARD AND THE MINISTRY OF  
MINES), AN ABLE VENEZUELAN CADRE IN THE FIELD AND THE SUPPORT OF  
AT LEAST EXXON FROM ABROAD. OVER THE LONGER RUN THERE IS THE  
DANGER OF THE POLITICAL INTERFERENCE, PAYROLL PADDING AND GENERAL  
CORRUPTION THAT AFFLICTS OTHER GOV STATE ENTERPRISES. VENEZUELAN  
KEEP WARNING ONE ANOTHER AND THEMSELVES ABOUT THE DIRE CONSE-  
QUENCES OF ALLOWING THE PETROLEUM INDUSTRY TO FALL INTO THIS  
PATTERN. WE THINK PUBLIC SCRUTINY WILL BE SUCH DURING 1976  
AS TO PRESERVE THE INDUSTRY'S INTEGRITY, BUT WOULD NOT VENTURE  
A PREDICTION FOR THE YEARS BEYOND. A MORE IMMEDIATE RISK ARISES

FROM THE NECESSITY FOR SUBSTANTIAL CONTINUING INVESTMENT IN VENEZUELA'S OLD FIELDS AND REFINERIES. IT WILL REQUIRE POLITICAL WILL TO MAKE THOSE INVESTMENTS IN THIS FREE-SPENDING ATMOSPHERE.

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PAGE 03 CARACA 00325 02 OF 02 092230Z

8. IN THE VENEZUELAN VIEW, FINAL "INDEPENDENCE" WILL COME WHEN THE COUNTRY IS NO LONGER DEPENDENT ON THE OUTSIDE FOR PETROLEUM TECHNOLOGY. THE GOV HAS BUDGETED SUBSTANTIAL SUMS TO ESTABLISH A PETROLEUM INSTITUTE AND IS FINANCING PETROLEUM TRAINING AND RESEARCH IN A NUMBER OF OTHER INSTITUTIONS. BUT FROM THE PRESIDENT ON DOWN, VENEZUELAN'S REALIZE THAT FOREIGN TECHNOLOGY--AND PARTICULARLY U.S. TECHNOLOGY--WILL BE NEEDED FOR A LONG TIME TO COME. THAT FACT IS PARTICULARLY PERTINENT TO THE PROBLEM OF THE MASSIVE ORINOCO PETROLIFEROUS BELT. DECISIONS MUST BE TAKEN FAIRLY SOON ON WHETHER TO COMMIT THE BILLIONS REQUIRED TO DEVELOP THE NEW TECHNOLOGY FOR THE BELT AND PUT THE PROJECT'S INFRASTRUCTURE IN PLACE BEFORE CONVENTIONAL RESERVES BEGIN TO RUN LOW. ARTICLE 5 OF THE NATIONALIZATION LAW WHICH PERMITS JOINT VENTURES WITH FOREIGN COMPANIES WOULD BE THE VEHICLE TO LAUNCH THIS ENORMOUS ENDEAVOUR SINCE VENEZUELA COULD SCARCELY HOPE TO TACKLE IT SUCCESSFULLY ALONE. SHLAUDEMAM

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